Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author:	Hollingsworth	Analyst:	Darrine Distefano	Bill Number:	AB 17
Related Bills:	See Legislative History	Telephone:	845-6458	Introduced Date:	12-04-2000
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: PIT Rate Reduction

SUMMARY

This bill would reduce all existing personal income tax (PIT) rates over a five-year period to zero so that income tax for all individuals is eliminated by the year 2005.

EFFECTIVE DATE

As a tax levy, this bill would be effective upon enactment and operative for taxable years beginning on or after January 1, 2001.

LEGISLATIVE HISTORY

AB 955 (1993-94, failed passage in the Assembly Revenue and Taxation Committee) would have established new amounts for the PIT brackets, the personal exemption credit, and the standard deduction. *AB 643* (1997-98, remained in the Assembly Revenue and Taxation Committee) would have provided a 10% reduction in PIT rates, phased in over two years. *AB 781* (1997-98, was amended and enrolled as the Education Technology Benchmark Implementation Trust Fund) would have re-established 10% and 11% PIT rates for tax years beginning on or after January 1, 1998, with the additional revenue transferred to the Education Technology Trust Fund. *SB 83* (1997-98, remained in the Senate Appropriations Committee) would have eliminated the 1% tax rate bracket for PIT taxpayers and indexed the income threshold amounts for the remaining tax brackets for inflation through the 1996 tax year. *SB 1165* (1997-98, failed passage in the Senate Revenue and Taxation Committee) would have provided a 15% reduction for each of the five rates from 1% to 8% for tax years beginning on or after January 1, 1997; provided a 15% reduction for the 9.3% rate phased in over two years; and created a new marginal rate for taxable income greater than $100,000 which would have been phased out over two years. *SB 1171* (1997-98, was amended to be a sales tax exemption) would have provided a 10% reduction in PIT rates, phased in over two years. *SB 2197* (1997-98, failed passage in the Senate Revenue and Taxation Committee) would have increased the threshold amounts of each PIT bracket by 10%.

SPECIFIC FINDINGS

Existing state law imposes six different tax rates ranging from 1% to 9.3%. Each tax rate applies to a different level of income also known as a bracket.

Board Position:			Department Director	Date
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Existing state law also provides a personal income alternative minimum tax (AMT) rate of 7%. A taxpayer with substantial income can use preferential tax benefits such as exclusions, deductions, and credits to reduce their income tax liability. AMT was established to ensure that a taxpayer in this situation cannot completely escape taxation.

Existing state law requires the Franchise Tax Board (FTB) to index the tax brackets and the AMT exemption amounts each year to account for inflation.

This bill beginning in tax year 2001 would incrementally reduce all personal income tax rates to zero by the year 2005, thus effectively eliminating the personal income tax.

The marginal rates proposed by **this bill** are in the following table:

PITL Marginal Rates					
Current	*2001*	*2002*	*2003*	*2004*	*2005*
1%	0.80%	0.60%	0.40%	0.20%	0%
2%	1.6%	1.2%	0.80%	0.40%	0%
4%	3.2%	2.4%	1.6%	0.80%	0%
6%	4.8%	3.6%	2.4%	1.2%	0%
8%	6.4%	4.8%	3.2%	1.6%	0%
9.3%	7.54%	5.58%	3.72%	1.86%	0%

This bill would apply to individuals, both residents and nonresidents, sole proprietorships, estates, and trusts.

<u>Policy Considerations</u>

This bill does not reference or change AMT. Reducing regular tax rates without a corresponding reduction in AMT rates would result in an increase in the number of taxpayers who would owe AMT.

Income taxes for sole proprietorships would be reduced and eventually eliminated by this bill. However, partnerships, limited liability companies, C and S corporations would continue to pay taxes (minimum tax, fee, or income or franchise tax) under existing law, thus creating different treatment for businesses based on their entity type.

<u>Implementation Considerations</u>

Implementing the rate reduction would require some changes to existing tax forms and instructions and information systems, which could be accomplished during normal annual update. However, the rate reduction would result in the elimination of many of the PIT programs within FTB by 2005. This would reduce a large amount of FTB's workload and the revenue it generates for the General Fund.

<u>Technical Considerations</u>

With the elimination of all marginal tax rates by the year 2005, the majority of the Personal Income Tax Laws (PITL) and certain articles pertaining to personal income tax in the Administration of the Franchise and Income Tax Laws and the Taxpayer Bill of Rights also would need rewording. If AMT for individuals was also eliminated, substantial portions of the PITL could be eliminated. Department staff is available to assist with these amendments.

FISCAL IMPACT

Departmental Costs

Initially, this bill would not significantly impact the department's costs as the same number of taxpayers would still be filing returns. Eventual elimination of the PIT programs would result in substantial cost savings for the department's budget. However, the department would still administer AMT, the refundable Child and Dependent Care Credit under the PITL, the Homeowner's and Renter's Assistance Program, Bank and Corporation Tax Law, Child Support, and other non-tax debt collection programs.

Tax Revenue Estimate

Based on the discussion below, this bill would result in revenue losses as shown in the following table:

Revenue Impact of AB 17 For Taxable Years Beginning 1/1/2001 Assumed Enactment After 6/30/01 Fiscal Years **(In Billions)**			
2001-02	**2002-03**	**2003-04**	**2004-05**
-$15	-$14	-$17	-$18

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this proposal.

Tax Revenue Discussion

The impact of this bill would depend on the amount of tax reductions resulting from the decrease in marginal tax rates, offset by an increase in the AMT. If the author's intent is to not only reduce the marginal tax rates, but also proportionately reduce AMT, revenue losses would be even higher.

The above estimates are based on the department's current personal income tax model expressed to the nearest billion dollars. Estimates should be considered preliminary because (1) the AMT issue is uncertain, and (2) an updated personal income tax model will be available in one to two months.

OTHER STATE INFORMATION

The majority of states impose income tax on individuals. Only Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming do not have personal income tax.

BOARD POSITION

Pending.